Long-Term Care Task Force
Briefing Paper

Issue: Life Insurance Annuities and Health Savings Accounts

Description: The private financial sector offers a variety of services and tools designed to help private citizens save for future health care costs and retirement. Two of these tools, life insurance annuities and health savings accounts, are discussed in this briefing paper. Life insurance annuities offer individuals a periodic benefit in exchange for an up-front investment. Typically, a sum of money is transferred to a bank or financial institution and is paid out on a regular basis to the annuitant (e.g., monthly).

Health Savings Accounts allow individuals to save money on a tax-free basis for use for a relatively broad range of future health care expenditures. Contributions can be made tax free (with annual contribution limits) and funds can be withdrawn tax-free if used for health related expenses.

Background: With the rise of health care and long term care costs, the private financial sector, with public sector enabling legislation, has developed a variety of services and tools to help private citizens save for future health care costs and retirement. Life insurance annuities and health savings accounts are two approaches that the Task Force on Long-Term Care Financing and Chronic Care Management (Task Force) may consider.

Life Insurance Annuities

Life insurance annuities allow an individual make a long-term investment that will provide a source of income upon retirement. For some annuities, investments can be made in lump sums or over time. Benefits are usually paid to annuitants monthly, quarterly or annually and provide a steady source of retirement income. Although some plans have terms (e.g., 10 years), benefits are typically paid for life. Annuities may especially be a viable option for middle income individuals who would want to purchase certain long term care without ever divesting their assets and qualifying for Medicaid.

> Note that for the purposes of qualifying for Medicaid, the federal Centers for Medicare and Medicaid Services (CMS), which oversees the Medicaid program, limits the purchase of annuities because the purchase of a life annuity allows individuals to move a large sum of money out of their countable resources, increasing their eligibility status for Medicaid and at the same time, for married individuals, providing income to their partners. CMS does allow annuities under certain circumstances (e.g., if the annuity is immediate and irrevocable, actuarially sound, and non-assignable), although many states have curbed the use of annuities for Medicaid applicants even further. If the Task Force opts to encourage the purchase of annuities, it should ensure protections are in place so people do not endanger potential Medicaid eligibility.

The drawback of annuities is that the market is susceptible to adverse selection in the pool of individuals who purchase annuities – that is, they are most attractive to individuals who expect higher than average longevity, based on family history or other indicators. Persons with lower life expectancy may opt for an annuity that pays in a lump sum, rather than over time. Although there is the risk of adverse selection, the private market has shown that these products are viable over time.

Exhibit 1: Sample Annuity Contribution and Annual Payout Amount

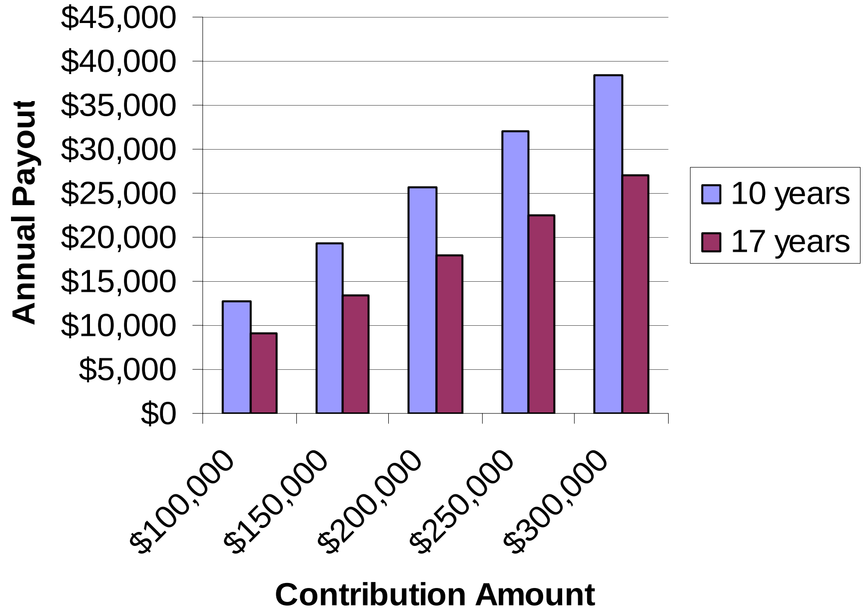

Exhibit 1 displays a sample annuity contribution and annual payment amount, based on differing levels of contribution. The model is based on a one-time contribution, a fixed interest rate of 6%, and the annual payout based on a 10 year policy or a 17 year policy (representing life expectancy for a person age 65).

Mark Warshawsky, now Assistant Secretary for Economic Policy, U.S. Department of Treasury, has advocated what he calls a "life care annuity," which combines a traditional annuity with long term care benefits.[1] For example, an individual's benefits would increase if he or she developed a severe disability, allowing him or her to pay for long term care services without depleting the monthly stipend.[2] The life care annuity would allow individuals to save funds in working years, provide incomes at retirement, and protect against the need for long term care services.

There are both state and federal statutes restricting use of long term care benefits that are combined with annuities. Washington's long term care insurance statute limits the use of long term care products outside of long term care insurance, such as long term care benefits as part of other insurance products, such as annuities. A similar federal law does not allow the combination of an annuity and a long term care benefit, but the House Energy and Commerce Subcommittee held a hearing on May 17, 2006 on the Flexible Retirement Security for Life Act of 2005, which would permit the combination of these products.

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[1] Note: His opinion does not reflect an official position of the U.S. Department of Treasury.

[2] Warshawsky, Mark J., Ph.D. "The Life Care Annuity: A Better Approach to Financing Long Term Care and Retirement Income. June 2002.

Health Savings Accounts

Health savings accounts, which are individual savings accounts for health care expenditures, could be encouraged by the Task Force. Qualified health savings accounts, created by the 2003 Medicare Modernization Act, allow individuals to save pre-tax dollars that can be used for qualified health-related expenditures, as long as they join a high-deductible health plan (HDHP), which insures them from catastrophic losses. Individuals can sign up for HSAs in banks, credit unions, or other financial institutions. An individual cannot qualify for an HSA if he or she has traditional health insurance coverage.

As of January 2006, there are 3.4 million Americans covered by health savings accounts, and much of this growth has occurred in the last year. Exhibit 2 shows that HSA/ HDHP coverage tripled between March 2005 and January 2006 in the group market and also grew significantly in the individual market.[3]

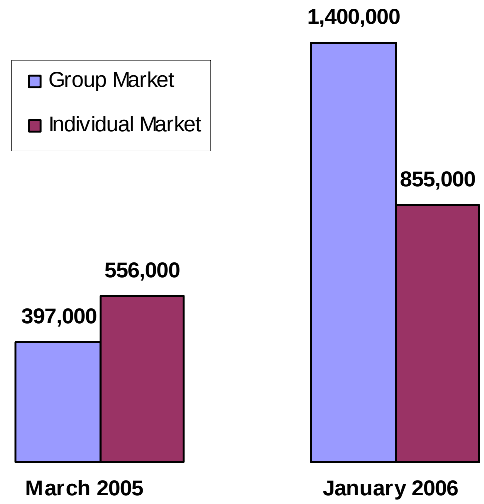
Because HSAs are a recent addition to the health care market, little data has been collected about the incomes of people who enroll in HSAs and their health care spending. Greater numbers of small businesses offer high-deductible HSAs to their employees, as the price of traditional health coverage has grown exponentially. Nationally, America's Health Insurance Plans reports that 31% of people purchasing HSAs/HDHPs were previously uninsured, while 69% replaced prior health insurance coverage.[4] Also, the President has proposed raising the annual tax-free contribution limits for HSAs.[5]

[3] America's Health Insurance Plans, Center for Policy and Research, January 2006. Note that there are 878,000 people who have HSA or HDHP coverage who are not classified in the group or individual market.

[4] Ibid.

[5] In 2006, the individual annual contribution limit was $2,700 and the family contribution was $5,450.

Exhibit 2. Growth in Number of People Covered by HSAs/HDHPs, 2005-2006



Source: America's Health Insurance Plans, Center for Policy and Research, January 2006. Note that there are 878,000 people who have HSA or HDHP coverage who are not classified in the group or individual market.

Supporters have advocated HSAs as a way to provide flexibility to individuals and greater choice in the health care market, because they would no longer be restricted by a third party insurer (e.g., elimination referral requirements and prior approval). Health savings accounts allow individuals to save for long term care expenses that may not be covered by health insurance companies or Medicare. (Note that persons on Medicare are ineligible for HSAs; those who had HSAs prior to enrolling in Medicare cannot make additional contributions, but can withdraw from their HSAs to pay for services not covered by Medicare.) Critics have challenged that HSAs do not pool risk, and therefore provide no pooled-risk insurance value, other than from catastrophic health care costs (because of the requirement to enroll in a HDHP).

In Washington, there are seven companies offering health savings accounts, as well as several banks and financial institutions that are offering these accounts. Data on the number of persons covered in Washington are not readily available, but the number of insurers offering HSAs/HDHPs has grown in recent years.

Exhibit 3: Insurers in Washington Offering Health Savings Accounts

	FOR INDIVIDUALS	FOR EMPLOYERS
Asuris Northwest Health		X
Cigna		X
Group Health Cooperative	X	X
KPS Health Plans	X	X
Lifewise Health Plan of Washington	X	
Premera Blue Cross		X
Regence Blue Shield	X	X

Source: HSA Pocket Guide, Washington Policy Center

Potential Approach:

The Task Force on Long-Term Care Financing and Chronic Care Management has several options related to the use of annuities or health savings accounts.

- On annuities, as noted above, the state and the federal government currently restrict the combination of annuities and long term care benefits. In order to allow for “life care” annuities, as described above, the state would have to enact state legislation to allow this arrangement and advocate for change at the federal level.

- For HSAs, the state could offer incentives to individuals to purchase health savings accounts that could help fund long term care services. Although the state has no income tax (and cannot offer those tax incentives) other incentives may include supporting insurers and banks that offer health savings accounts and developing strategies to allow HSAs to be developed specifically around the needs of long term care consumers.

- For both annuities and HSAs, the state could support their expansion by providing funding for public awareness and education about these options.